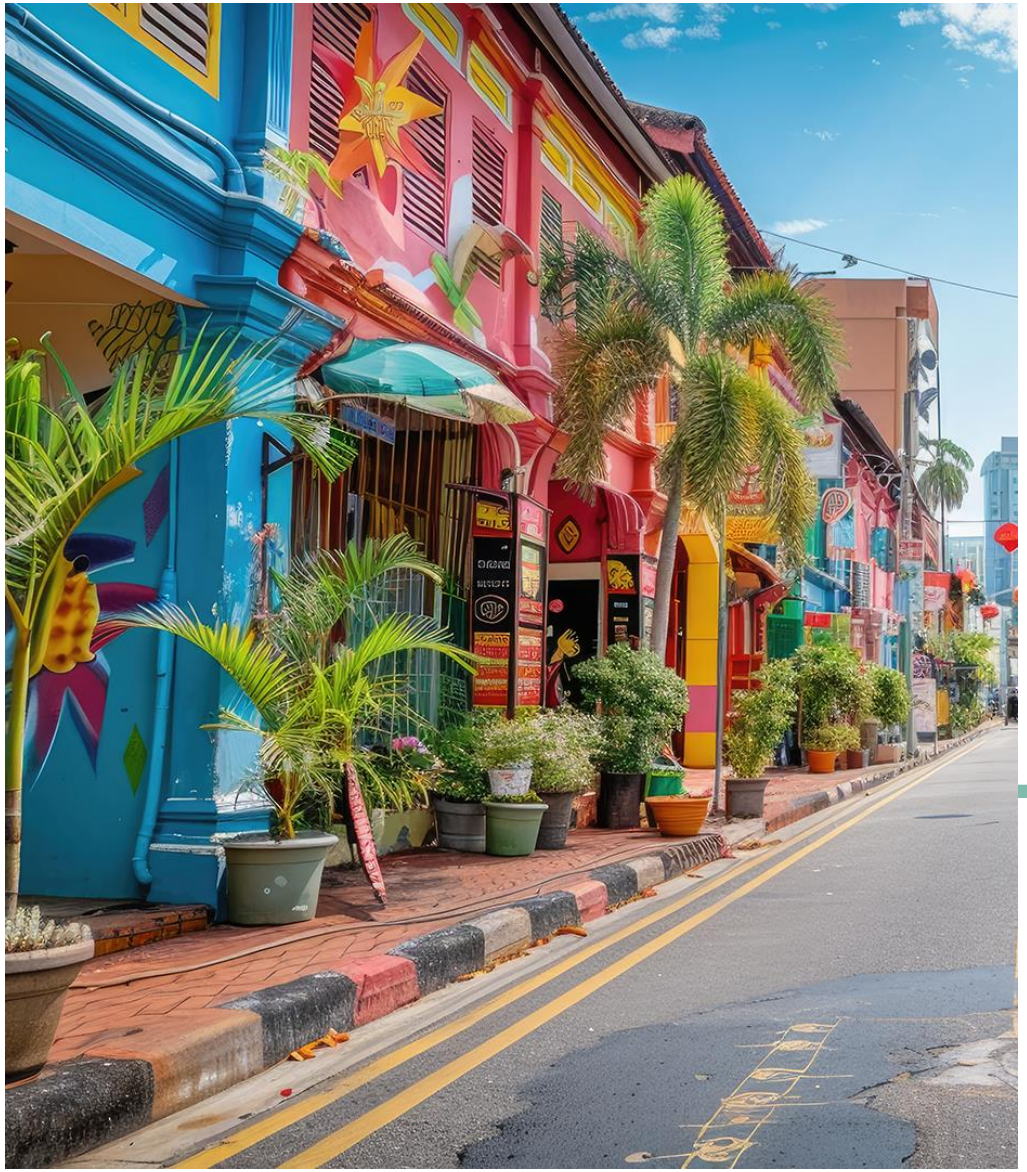
Viewpoint

Singapore Conservation Shophouse Market

REPORT

A unique asset class with enduring value

SINGAPORE RESEARCH
AUGUST 2024



Summary

Conservation shophouses have emerged as one of the top alternative real estate asset class over the past decade in Singapore. Besides their finite supply and vintage charm, they are among the few asset classes in Singapore that allow foreigners and companies to own boutique buildings at a palatable quantum. Transaction volumes hit a peak of $1.9 bn in 2021 before declining on high financing costs, record price points and most recently, overhang from the $3 bn money laundering case. CBRE Research believes the underlying fundamentals for shophouses remain solid, notwithstanding certain challenges in the near term. This report looks at the past, present and future for conservation shophouses, and recommends actionable strategies for investors.

What is a Shophouse?

Shophouses are generally two-to-three storey narrow terraced houses built in contiguous blocks with common party walls and fronted by a sheltered ‘five foot’ pedestrian way. Built between the 1840s and the 1960s, they are one of the oldest forms of real estate in Singapore and form the bulk of gazetted conservation buildings. Conservation shophouses are subjected to URA’s conservation guidelines.

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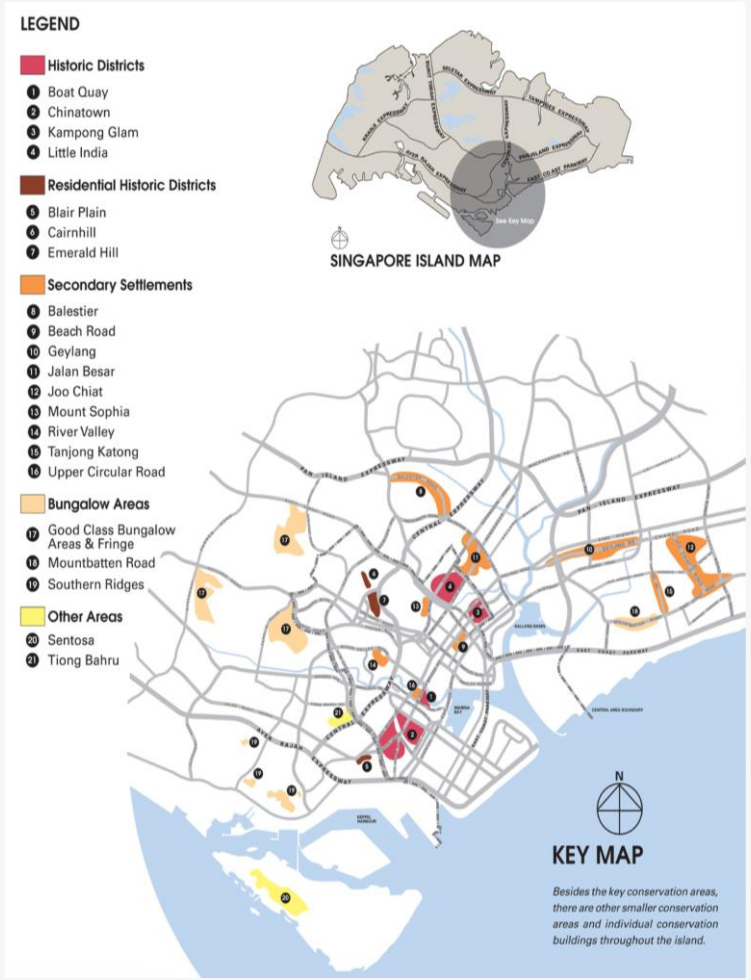
01 ——The Scarcity and Heritage Value of Shophouses

According to the Urban Redevelopment Authority (URA), there are only around 6,500 shophouses in Singapore, with most of them located in the Rochor and Outram areas.

Constructed between the early-1800s and mid-1900s, conservation shophouses were originally erected primarily around the city centre to facilitate trade and serve as residential spaces. Post-World War II, many shophouses were demolished to make way for the nation's development. However, in recognition of the need to preserve Singapore's heritage assets, URA rolled out its Conservation Master Plan in 1986, which designated six areas for conservation, including shophouses in Chinatown, Boat Quay, Little India, and Kampong Glam. This set the stage for subsequent initiatives that resulted in conservation gazetting of the remaining shophouses in the city fringe and other areas.

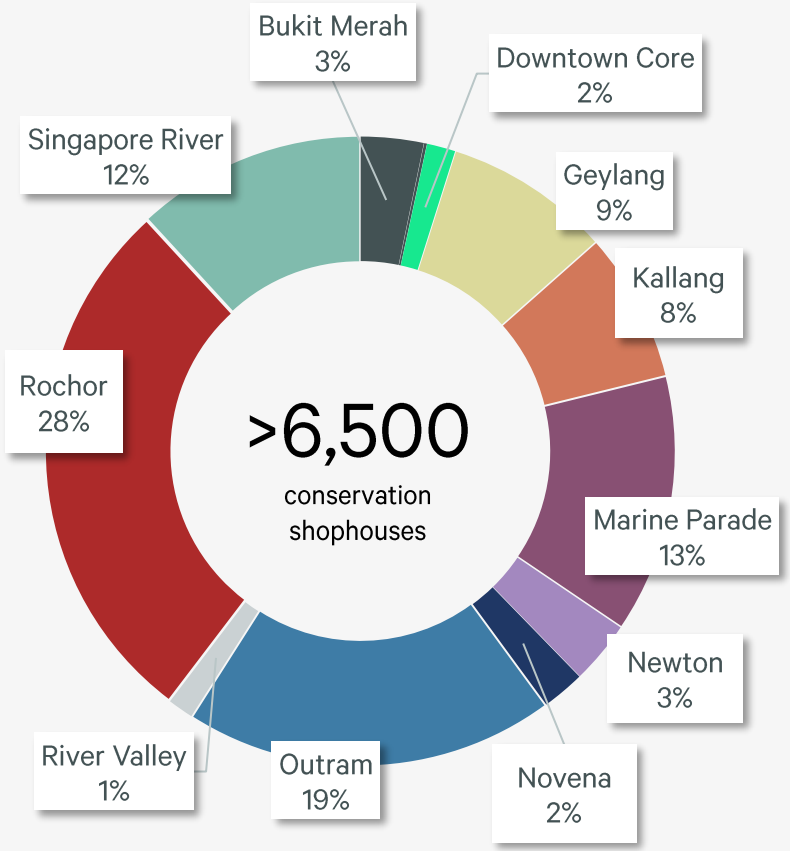
Given the absence of new supply in the market, the scarcity of shophouses offers potential for capital appreciation and long-term wealth preservation. In addition, their colourful facades and ornate designs lend a unique charm to the building, allowing owners to possess a piece of history while also contributing to the preservation of Singapore's heritage.

Fig. 1: Key Conservation Areas



Source: URA

Fig. 2: Location of Shophouses in Singapore



Source: CBRE Research, URA

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02 — Lower Investment Quantum; Strong Underlying Fundamentals

❖ Lower investment quantum and transaction costs

The investment quantum typically ranges from $5 mil for a 2,000 sq. ft. shophouse to $25 mil for a 5,000 sq. ft. shophouse, which entails ownership of the building. This outlay is more palatable compared to single entity-owned buildings, which usually exceed $200 mil. Shophouses are thus more accessible to high-net-worth individuals (HNWI) or boutique investors such as family offices.

For a comparable investment quantum, shophouses also offer lower transaction costs compared to residential properties. Acquirers of shophouses for commercial use are required to pay Buyer's Stamp Duty (BSD) of about 5%, while residential assets are subjected to BSD of up to 6%, 20% - 65% Additional Buyer's Stamp Duty (ABSD) and up to 12% Seller's Stamp Duty (SSD, payable if a property is sold within the holding period of three years).

❖ Portfolio diversification benefits

Amid the current elevated interest rates and weak economic environment, investors who wish to diversify their portfolio beyond the financial markets due to volatility could consider shophouses given the palatable investment quantum, different cycles and risk profiles.

❖ Flexibility in space usage

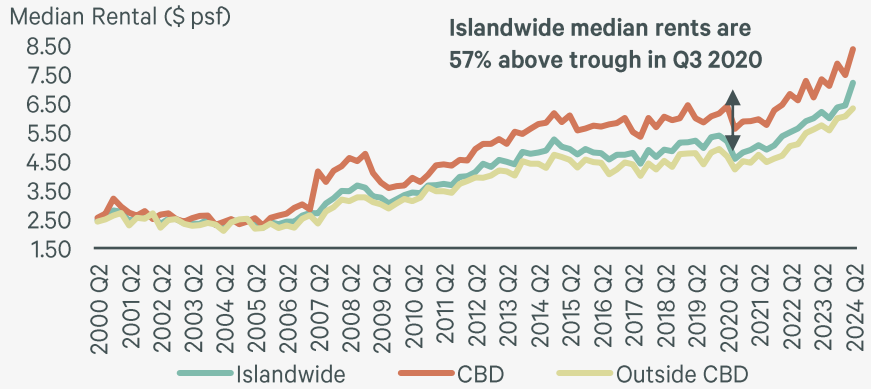
Conservation shophouses offer versatile usage options. They can be used as residential units, commercial spaces, or a combination of both. In recent years, investors have even converted conservation shophouses to co-living spaces or hotels. This flexibility allows owners to adapt the property to their needs and optimise its value.

❖ Strong underlying rent growth

Shophouse rents held steady from 2014 – 2019. While median rents fell in 2020 due to COVID-19, rents started recovering in 2021 as demand for office spaces returned and retailers increasingly sought shophouse locations. The ever-evolving retail landscape post-pandemic saw more retailers and F&B brands looking to offer consumers a different experience from malls.

As at Q2 2024, the islandwide median rent for shophouses has recovered 57% above its trough in Q3 2020, reaching a high of $7.21 psf. While CBD and non-CBD shophouses are both witnessing record median rents, CBD assets command a premium of 20 - 38% over the non-CBD ones due to their prime location.

Fig. 3: Median Rental of Shophouses



Source: CBRE Research, URA

CBRE Research estimates that rents for office use, which are typically in the upper floors, average $6 - $9 psf pm in the CBD, and around $3 - $5 psf pm outside the CBD. Meanwhile, rents for retailers, typically on the ground floor, average c.$10 - $15 psf pm in the CBD, and $8 - $13 psf pm outside the CBD.

This translates into yields of 3 – 4% and 2 – 3% based on an average of $2,000 – $3,000 psf (on GFA) and $3,000 - $5,000 psf (on GFA) for leasehold and freehold assets respectively.

CBRE Research expects rents to continue increasing on the back of sustained robust office and retail fundamentals amid normalisation of return-to-office arrangements and tourism recovery.

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03 — Transaction Volumes Could Recover

Based on URA transaction data, shophouse sale volumes and average prices grew steadily since 2014, before peaking in 2018, on increased foreign investor interest and pivoting of investors out of residential assets after the introduction of ABSD measures in Jul 2018.

While shophouse transactions and prices cooled in 2019 from a high base, and into 2020 due to COVID-19, volumes surged in 2021 amid strong capital inflows on Singapore's status as a safe haven, economic recovery from the pandemic and low borrowing costs. Acquirers of shophouses comprise a mix of locals and foreigners, including Chinese and Malaysians, and range from HNWI, family offices to local companies and boutique real estate funds. Shophouses could be purchased for self-use, rental or a hybrid of both.

The increase in demand, coupled with limited supply in view of strong holding power of owners, led to soaring prices.

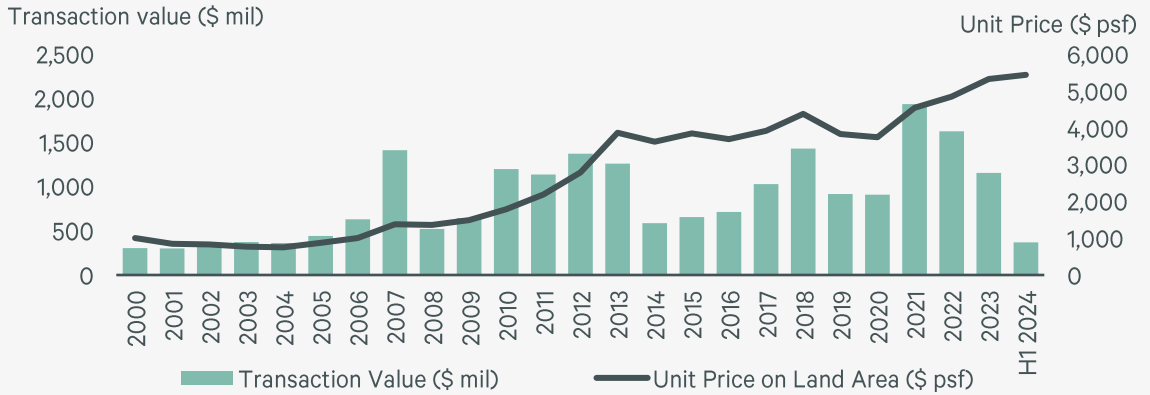
As bid-ask spreads between buyers and sellers widened and escalating funding costs outstripped investment yields, in addition to the tightening of the Total Debt Servicing Ratio (TDSR) threshold from 60% to 50% in Dec 2021, transaction volumes started falling in H2 2022.

Money laundering investigations from Aug 2023 further dampened investor sentiments. With the repossessed shophouses back in the market, many sellers have refrained from offering their properties for sale as they adopt a wait-and-see approach.

Transaction volumes in H1 2024 stood at $367.54 mil, a mere 31.8% of 2023 full-year volumes. That said, DBS has reportedly accepted offers totalling over $100 mil for 13 of the mortgaged shophouses linked to the money launderers.

With intense competition for the repossessed shophouses, CBRE Research believes that market sentiments are turning positive, and volumes could start recovering when interest rate cuts materialise.

Fig. 4: Shophouse Transaction Volumes and Prices



Source: CBRE Research, URA, caveats downloaded as of 8 Aug 2024
Note: GFA for shophouses are unique and not widely available as transactions only register land areas., CBRE Research thus uses prices on a land area basis over time as a proxy to shophouse pricing trends. Unit price excludes *The Rail Mall* which is an outlier.

Fig. 5: Significant Shophouse Transactions, 2023 – H1 2024

Project Name	Price ($ mil)	Unit Price on GFA ($ psf)	Remaining Tenure	Buyer	Seller
51 Club Street	92.20	3,193	999 years	Zhang Nie (Chinese citizen/ Singapore permanent resident)	Liberty Insurance
2 - 7 Circular Road	80.00	4,706	999 years	Su Fuxiang (Chinese national)	Lim Teck Lee Pte Ltd
The Rail Mall	78.50	1,574 (on NLA)	22 years	Woh Hup	Paragon REIT
322,324,330 etc Serangoon Road	62.50	4,093	Freehold	Singapore Maritime Officers' Union	Singapore family
70, 71 & 72 Duxton Road	47.50	4,439	64 years	Zhang Ying (wife of Alibaba Group co-founder Jack Ma)	Entity linked to a Singapore-based property investment group

Source: CBRE Research, URA

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04 —— Conservation and Cost Matters

❖ Higher maintenance costs

While old is gold, shophouse investing is not without its challenges. Constructed between the 1840s and 1960s, most conservation shophouses are now over 60 - 180 years old. Due to architectural designs (such as high ceilings) and material differences, costs to restore and maintain these buildings are typically higher.

❖ Conservation restrictions

URA guidelines for conservation shophouses dictate that all original structural and architectural elements are to be retained and restored. These guidelines are applied to varying degrees on the conservation areas, depending on their historical significance, the context of their surroundings, and long-term planning intentions. For example, rear extensions are permitted for both the Residential Historic Districts and Secondary Settlements, with conservation focused on the streetscape for the latter.

Meanwhile, Historic Districts are subjected to the most stringent criteria, where the entire building is conserved. These areas also face further usage restrictions to ensure that the character of the area is maintained. Additionally, certain streets within the Historic Districts in Chinatown, Kampong Glam and Little India are designated as core areas, where traditional activities are centred in.

In order to retain the traditional ambience, the first storey of shophouses within core areas are strictly for activity-generating uses such as shops, fitness centres or certain food and beverage establishments.

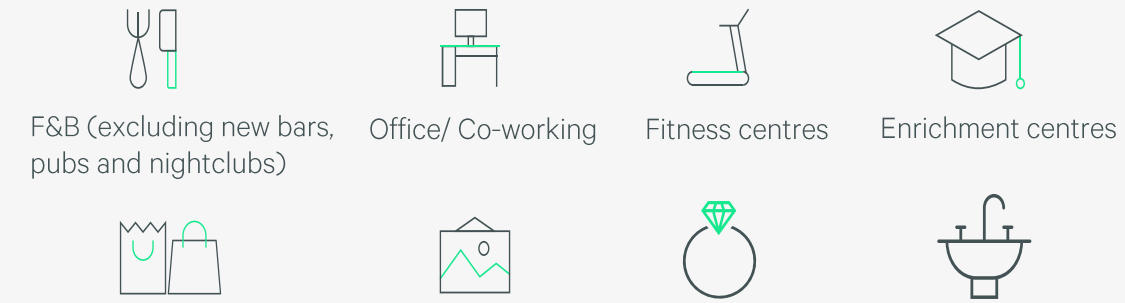
Shophouse owners seeking adaptive reuse for their properties are required to adhere to conservation guidelines. In addition, it is crucial to familiarise themselves with the existing usage permissions and regulations as these affect the type of tenants that shophouse owners can place within their premises, and in turn, the returns for the property.

Fig. 6: Shophouse Conservation Areas & Guidelines

District	Conservation Guidelines
Historic Districts	Most original shophouse establishments are still intact. The strictest form of conservation is practised in these districts, where the entire building must be conserved.
Residential Historic Districts	Shophouses are mainly for residential use. An extension at the rear lower than the main roof is permitted.
Secondary Settlements	As shophouses are adjacent to new developments, conservation is carried out on a streetscape basis. Owners may conserve the entire building or develop a new rear extension up to the maximum height allowable for the area.

Source: CBRE Research, URA

Fig. 7: Key Permissible Uses in Historic Districts (Subject to Regulatory Approval)



Source: CBRE Research, URA

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05 — Recommendations and Strategies for Investing in a Shophouse

❖ Consider location, condition and environment of the shophouse

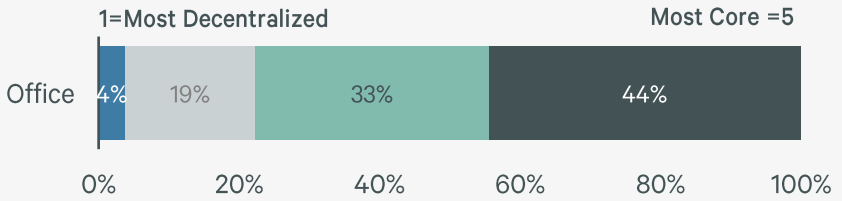
Most investors favour shophouses located in prime areas such as the CBD as they are better connected. CBRE's Asia Pacific Leasing Sentiment Index showed that while majority of both office and retail occupiers prefer to be situated in core areas, a significant proportion of retailers also seek fringe locations. Lifestyle enclaves have formed in various fringe and decentralised shophouse areas such as Holland Village, Serangoon Gardens and Joo Chiat, appealing to various communities.

Given the surge in prices of CBD shophouses, investors can consider fringe locations with growth potential such as Lavender and MacPherson which could see increased footfall from future residential catchments.

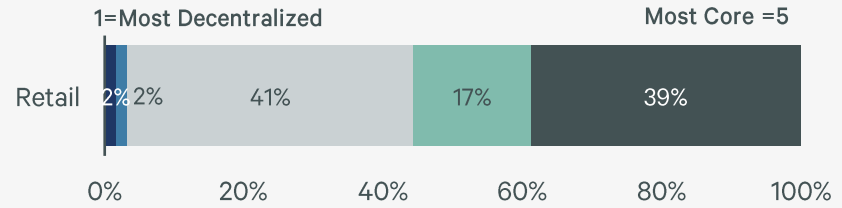
In addition, shophouses facing the main road tend to have greater visibility and footfall compared to those located on inner streets. This will influence the tenant and rental profile.

With conservation at its core, the shophouse's condition is also important. Investors need to consider the existing condition of the shophouse, and the potential costs to reposition or refurbish given the strict requirements.

Fig. 8: Occupier's Location Preference



Source: Singapore Leasing Sentiment Index, CBRE Research, Mar 2024



Source: Asia Pacific Leasing Sentiment Index, CBRE Research, Mar 2024

As shophouses could be individually-owned, a single owner may have little control over the common areas, amenities (such as carpark space) and the trade mix in the area. Nonetheless, improved transport network and accessibility, as well as neighbourhood gentrification of several shophouse zones over the years have lifted the occupancy, rents and capital values of the shophouse market.

❖ Enhance, redesign, reposition the shophouse to unlock value

While rents are largely contingent on location and trade of retailers, investors can seek to add value through various initiatives.

These include embarking on minor asset enhancement works such as fitting-out office spaces as tenants are typically willing to pay a premium for units that are in move-in condition.

Owners can also reposition and convert the shophouse to alternative and higher-value uses such as co-living. In Mar 2022, a row of 17 conservation shophouses in Kampong Glam was sold to Weave Living, who redesigned its maiden acquisition in Singapore to a serviced residence with communal and amenity space on the ground floor.

Investors could also create a lifestyle cluster through the amalgamation of several shophouse units. Some institutional investors have curated several F&B hubs in Keong Saik Road, Amoy Street and Tanjong Pagar Road over the years.

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